THE SOCIAL FUNCTION OF PRIVATE CORPORATIONS

SULPICIO GUEVARA*

The Legal Concept of Private Corporations

A private corporation, in legal contemplation, although formed by several individuals, has a personality, distinct and separate from the personality of its individual members or stockholders. Our law defines it as "an artificial being" created by operation of law.[1] According to Justice Marshall of the U.S. Supreme Court, it is "intangible" and "exists only in contemplation of law.[2] If this is so, then it has no "*soul*", and therefore, also has no "*conscience.*".

Our law invests a private corporation with limited powers. It can exercise only such acts as are "expressly" authorized by the law or "incident" to its existence.[3] This means that it can exercise only such acts which will accomplish the purpose for which it has been incorporated. And the purpose of every private corporation, (except those organized for charity or eleemosynary purposes) is said principally to obtain profit,—profit for the corporation and, consequently, for the stockholders or investors.

Even in the acquisition or holding of property, the law authorizes a private corporation to deal only with such real and personal property "as the purposes for which the corporation was formed may permit, and the transaction of the lawful business of the corporation may reasonably and necessarily require.[4] Our Corporation Law, therefore, *prohibits* a private corporation:

> To conduct the business of buying and selling public lands;
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> To hold or own real estate except such as may be reasonably necessary to enable it to carry out the purposes for which it has been organized;
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> If engaged in agriculture, to own or control more than 1024 hectares of land;
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> If engaged in agriculture or in mining, to own in excess of 15% of the voting stock of any other agricultural or mining corporation;
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> Except insurance companies, to hold real estate for more than 5 years after receiving title thereto, where such real estate was purchased as a result of foreclosure proceedings arising out of a loan for which such real estate was given as security;

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* A.B., LL.B., LL.M.: Profesbor of Law, College of Law, U.P.

1 Act No. 1459, Sec. 2.

2 Dartmouth College v. Woodward, 4 Wheat. (U.S.) 518, 4 L. Ed. 629 (1819)

3 Act No. 1459, Sec. 2.

4 Id., Sec. 18, par. 5.

> To make by-laws inconsistent with the corporation law;
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> To enter into any obligation or contract which is not essential to the proper administration of its corporate affairs or necessary for the proper transaction of the business for which the corporation was incorporated;
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> To acquire, hold, mortgage, pledge, or dispose of shares, bonds securities, and other evidences of indebtedness of any domestic or foreign corporation which is alien to the purpose as stated in the articles of incorporation.

Again, Section 14 of the Corporation Law emphasizes that "no corporation created under this Act shall possess or exercise any corporate powers *except* those conferred by this Act and *except* such as are *necessary* to the powers so conferred."

Neither could the corporation under our law issue stock dividends,[5] increase or diminish its capital stock, create or increase its bonded indebtedness[6], invest its funds in another corporation or business[7], amend its articles of incorporation[8], or its by-laws[9], without the approval of the prescribed vote of the stockholders or members of the corporation.

Although the corporate powers of private corporations organized under the Corporation Law are exercised and controlled by a board of directors[10], yet these powers of the board are necessarily *limited,* because all the limitations imposed by law on private corporations are necessarily imposed also on the board of directors who act in behalf of the corporation. In other words, what is *ultra vires* or beyond the power on the part of the corporation must also be *ultra vires* or beyond the power on the part of its board of directors.

A private corporation is a mere creation of the law. And so, the court held that "a corporation, being the mere creature of law, possesses only those properties which the charter of its creation confers upon it, *either expressly, or as incidental* to its very existence."[11] The consent or acquiescence of *all* the stockholders or members of the corporation can give a corporation no legal right to engage in acts or in transactions foreign to the objects for which it was created, or render such acts or transactions any the less *ultra vires.*"[12] It has also been held that a private corporation cannot clothe itself with a power merely by naming it in its articles of incorporation, because the Corporation Law or the charter, and

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5 Id., Sec. 16.
6 Id., Sec. 17.
7 Id., Sec. 17½.
8 Id., Sec. 18.
9 Id., Sec. 22.
10 Id., Sec. 28.
11 Dartmouth College v. Woodward, supra.
12 14-A C., Sec. 2076, p. 251.

not its articles of incorporation or the by-laws, is the measure of its powers.[13]

In other words, a private corporation, unlike an individual, is given the power to perform acts for its own benefit but not those which will not *necessarily* acocmplish the object as stated in its articles of incorporation.

The Laissez Faire Doctrine

This legal concept of a private corporation must have been based on the nineteenth century economic doctrine of *laissez faire*. So, the early decisions of the courts, influenced by this doctrine, held that a business corporation exists *solely* for the benefit of those who had invested their capital in it. Thus, in the case of *Dodge v. Ford Motor Co.*[14], desiring to plow back the profits of the business to the corporation to enable him to sell cheaper cars for the benefit of the buying public, decided not to make further declaration of cash dividends. The minority stockholders complained, claiming that Mr. Ford had no business of making business for the benefit of strangers. The court sustained the contention of the minority stockholders, holding that:

> "Under a legal system based on private ownership and freedom of contract, he (Mr. Ford) has *no duty* to conduct his business to any extent for the benefit of strangers; he conducts it solely for his own private gain and never to those with whom he deals only the duty of carrying out such bargains as he may make with them."
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> "A business corporation is organized and carried on *primarily* for the benefit of the stockholders", and that the directors cannot lawfully —
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> "conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others."

It has also been held that the property of a private corporation, unless "affected with a public interest" may be sold by the owner at any price at which his property shall be sold or used, as

> "it is an inherent attribute of the property itself". And "the mere fact that the public derives benefit, accomodation, ease, or enjoyment from the existence or operation of the business" does not make the business "affected with a public interest."[15]

and business affected with a public interest are only of three classes, according to the cases:[16]

> 1. Those which are carried on under the authority of a *public grant* of privileges which either expressly or impliedly imposes the

13 Oregon Ry. etc. Co. v. Oregonian R. Co., 130 U.S. 1, 32 L. Ed. 837 (1889).
14 204 Mich. 507, 170 N.W. 684 (1919).
15 Tyson et al v. Banton, 273 U.S. 418 (1927).
16 Wolf Co. v. Industrial Court, 262 U.S. 522, 43 S. Ct. 630, 67 L. Ed. 1103.

affirmative duty of rendering a public service; such as railroads, other common carriers and public utilities;

2. Certain occupations regarded as *exceptional*, the public interest attaching to which, recognized from earliest times, has survived the period of arbitrary laws for regulating all trades and callings; such as the keepers of inns, cabs, and gristmills;
3. Businesses which though not public at their inception may be fairly said to have risen to be such and have become subject in consequence to some government regulation, having come to hold such a peculiar relation to the public that this is superimposed upon them.

In general, a business or property, in order to be affected with a public interest, must be such or be so employed as to justify the conclusion that it has been *devoted* to a public use and its use thereby, in effect granted to the public."[17]

An example of a private corporation affected with a public interest is a corporation engaged in insurance business.[18]

But it has been held that a theatre corporation does not come under the same category of an insurance corporation; it is not a public utility, and may, therefore, fix the price of its tickets at any price, without regard to public complaint. Said the United States Supreme Court in the case of *Tyson et al. v. Bonton*:[19]

"The contention that, historically considered, places of entertainment may be regarded as so affected with a public interest as to justify legislative regulation of their charges, does not seem to us impressive. It may be true, as asserted, that, among the Greeks, amusement and instruction of the people through the drama was one of the duties of government. But certainly, no such duty devolves upon any American government. The most that can be said is that the theatre and other places of entertainment, generally have been regarded as of high value to the people. x x x

"It is urged that the statutory provision under review may be upheld as an appropriate method of preventing fraud, extortion, collusive arrangements between the management and those engaged in reselling tickets, and the like. That such evils exist in some degree in connection with the theatrical business and its ally, the ticket broker, is undoubtedly true; as it unfortunately is true in respect of the same or similar as it unfortunately is true in respect of the same or similar evils in other kinds of business. But evils are to be suppressed or prevented by legislation which comports with the Constitution, and not by such as strikes down those essential rights of private property protected by that instrument against undue governmental interference."

17 Tyson et al v. Banton, 273 U.S. 418, 434 (1927).
18 Id., p. 437.
19 Tyson et al v. aBnton, 273 U.S. 418, 441 (1927).

It can be seen that the legal as well as the social concept of a private corporation had been predicated on the doctrine of *laissez faire.*

Changing Attitudes Towards Legal Fictions

That a private corporation has a personality distinct and separate from the personality of its constituents is but a legal fiction, and all legal fictions, to promote justice and equity, must give way to *realities.* In proper cases, the courts have disregarded the corporate fiction and treated corporations as mere aggregation of individuals. As one court said: "The abstraction of the corporate entity should never be allowed to bar out and pervert the real and obvious truth."[20] And, the real and obvious truth about private corporations is, that once they have voluntarily agreed to do business in a community, they thereby become at once members of that community, with duties and obligations which cannot be far different from the duties and obligations ordinarily expected of members in an organized, progressive, and progressing society.

Hence, some jurists foresaw the changing patterns of legal theories.[21] As Mr. Justice Holmes of the U.S. Supreme Court said in his dissenting opinion in the *Tyson* case:

> "Lotteries were thought useful adjuncts of the state a century or so ago; now they are believed to be immoral and they have been stopped. Wine has been thought good for man from the time of the Apostles until recent years. . . . What has happened to lotteries and wine might happen to theatres in some moral storm of the future, not because theatres were devoted to a public use, but because people had come to think that way."

So, some men are beginning to realize that private corporations are *not* strictly *private,* that they do not exist solely for their own benefit, but that they are deemed legitimate members of an organic society in which they move about. They may freely do things, in spite of the legal limitations surrounding a corporate entity, if such an act is intended and will directly benefit the community. In other words, the doctrine of *ultra vires* does not apply, and should not be applied, to acts done in favor of the public. Society is a living, growing organism, and its amelioration is a function of all its members, whether natural or juridical. "The great problem of the present day", said Henry Carter Adams, "is properly to correlate public and private activity so as to preserve harmony and proportion between the various parts of an organic society."[22]

The case of *A. P. Smith Mfg. Co. v. Barlow*[23] was the first positive judicial pronouncement that sought to harmonize the private

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20 Seymour v. Spring Forest Cemetery Assoc., 144 N.C. 333, 340, 39 N.E. 305.

21 See "For Whom Are Corporate Managers Trustees?", by Prof. E. Merrick Dodd, Jr., 45 Harv. L. Rev. 1145 (1932).

22 Relation of the State to Industrial Action and Economics and Jurisprudence, by Joseph Dorfman (1954).

23 13 N.J. 145, 98 Atl. 581 (1953).

and the public functions of a business corporation. This case involves the validity of a donation made by the A. P. Smith Manufacturing Company to Princeton University. The A. P. Smith Mfg. Co. is a New Jersey corporation, incorporated in 1896, engaged, in the manufacture and sale of valves, fire hydrants and special equipment, mainly for water and gas industries. On July 20, 1951, its board of directors appropriated the sum of $1,500 to be transferred by the corporation's treasurer to the university as a contribution towards its maintenance. This action was questioned by the stockholders on the ground that it was *ultra vires* or beyond the power of the corporation to do so. The Supreme Court of New Jersey, speaking through Justice Jacobs, said:

> "It seems to us that just as the conditions prevailing when corporations were originally created required that they serve public as well as private interests, modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate. Within this broad concept there is no difficulty in sustaining, as incidental to their proper objects and in aid of the public welfare, the power of corporations to contribute corporate funds in support of academic institutions."[24]

In this case, the testimonies of eminent American businessmen had been taken by the court, and it appeared that these men considered business as a profession of public service. All of them had a true concept of the social functions of private corporations. It was recorded that:

> "Mr. Hubert F. O'Brien, the president of the company, testified that he considered the contribution to be a sound investment, that the public expects corporations to aid philanthropic and benevolent institutions, that they obtain good will in the community by so doing, and that their charitable donations create favorable environment for their business operations. In addition, he expressed the thought that in contributing to liberal arts institutions, corporations were furthering their self-interest in assuring the free flow of properly trained personnel for administrative and other corporate employment. "Mr. Frank W. Abrams, chairman of the board of the Standard Oil Co. of New Jersey, testified that corporations are expected to acknowledge their public responsibilities in support of the essential elements of our free enterprise system. He indicated that it was not 'good business' to disappoint 'this reasonable and justified, public expectation' nor was it good business for corporations 'to take substantial benefits from their membership in the economic community while avoiding the normally accepted obligations of citizenship in the social community'. Mr. Irving S. Olds, former chairman of the board of the United States Steel Corporation, pointed out that corporations have a self-interest in the maintenance of liberal education as the bulwark of good government. He stated that "capitalism and free

24 13 N.J. 145, 98 Atl. 581, 586 (1953).

> enterprise owe their survival in no small degree to the existence of our private, independent universities' and that if American business does not aid in their maintenance it is not 'properly protecting the long-range interest of its stockholders, its employees and its customers'".[25]

In the case of *Sorensen v. Chicago, Burlington & Quincy*,[26] the same line of thinking was followed. This case involves the validity of a state authorizing railroads to give free passes to ministers of religion, inmates of charitable institutions and charitable works. Justice Letton of Nebraska, in deciding the question, said:

> "We see no reason why if a railroad company desires to foster, encourage, and contribute to a charitable enterprise, or to one designed for the public weal and welfare, it may not do so. x x x We see no reason why a railroad corporation may not, to a reasonable extent, donate funds or services to aid in good works."

In the United States, it had been estimated that private corporations in 1953 gave over 300 million dollars with over 60 million dollars thereof going over to universities and other educational institutions. Local community chests received well over 40% of their contributions from corporations.

This American corporate practice was subsequently recognized and sanctioned by state legislation. At present, at least 34 states in the American Union have statutes *expressly* authorizing private corporations to make contributions for public welfare. In many of them, corporations are empowered to donate only to charity. In some of them, the statute specifically empowers them to contribute not only to charity but also to "public welfare," which is indeed a broad power. And a few of them, like Maryland and Minnesota, the statute is still much broader in scope, obliging private corporations to contribute to the "*state or any political subdivision thereof.*" This last kind of express power granted to private corporations is one which is the most significant, because by this means, the economic and social problems of many a community in the Philippines may, perhaps, be solved.

The Role of Private Corporations in the Philippines

The present Philippine Corporation Law was patterned after, and is a codification of, the American corporate law.[27] But apparently, only the American corporate *form*, not the corporate *practice*, had been copied. Unlike their American counterparts which had been exercising broad powers in giving away corporate funds for public welfare (even before statutes had been enacted empowering them to do so), our business corporations, as a general rule,

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25 13 N.J. 145, 98 Atl. 581, 582-583 (1953).

26 112 Neb. 248, 255, 199 N.W. 584, 587 (1954).

27 Harden v. Benguet Consolidated Mining Co., 58 Phil. 141 (1933).

have not thought of playing an active role in the civic improvement of the community in which they operate. A fine example of corporate consciousness towards community development was the act of a foreign corporation,[28] the General Foods Corporation of America, which was reported to have given a grant of $105,000 to the city of San Pablo, Laguna, to be used in the creation of a community center for social and civic development of the said city. Many Philippine corporations could have done the same thing, for it cannot be denied that they have an annual gross income far greater than most municipalities have. On the other hand, many of our barrios do not have a decent schoolhouse, a health clinic, a public playground, or even an artesian well. Would it be too much for a multi-million-peso corporation, like the La Perla Cigar & Cigarette Factory (which had advertised itself of having paid more than 3 million pesos in specific taxes alone for the month of January (1959), to build a small schoolhouse in one or two barrios of its choice? There are as many big business corporations as there are municipalities in the Philippines. If each of them could take care of even one barrio in each municipality as its pilot project, there will be real rural progress in the Philippines. Such civic acts would not adversely affect the financial condition of the corporation, but they certainly would add a lot of difference to the lives of many of our rural folks whose economic and social condition for the last 350 years had remained substantially the same. Such a new concept of corporate function would create more immediate and effective results than by giving our barrios more local autonomy.

Our business corporations need not wait for a statute similar to those enacted in 34 states in the United States empowering them to give aids to public welfare. Under our existing tax laws, they may legitimately deduct from their net income contributions to or for the use of the Government, or to domestic corporations or associations organized and operated exclusively for religious, charitable, scientific, athletic, cultural or educational purposes, in an amount not in excess of 3% of the taxpayer's net income.[29] It could, therefore, be inferred that if the Government allows private corporations to make deductions from their net income for contributions to the government or for public welfare, the power to contribute

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28 Incidentally, the encouragement of foreign corporations to do business in the Philippines may accelerate the social and economic development of the Philippines. They certainly could be of great help, especially at this time when the international dollar reserve of the country is at a perilous level. The objectives of the Central Bank "to promote a rising level of production, employment and real income in the Philippines" could be better accomplished with the help of foreign corporations who are willing to invest their capital in the country. For this purpos, adequate facilties and incentives should be given to them, subject only to reasonable safeguards which are fair both to the investors and to the Filipino people. A Central Bank, with all powers of exchange and import control, alone cannot solve the countrry's economic imbalance. That will need the cooperation of business corporations, especially of foreign corporations who have millions of dollars to risk in trade and commerce, and who are willing to play their role in the social and economic amelioration of the community in wrich they operate.

29 C.A. No. 466, Sec. 30.

for public welfare, even in the absence of a provision in the corporation law, is deemed impliedly granted. The only trouble with our tax law, is that it limits to only 3% of the corporation's net income that may be deducted as corporate gift, which fact may inhibit the corporation to give more. Our tax law, in this respect, is unwise, and should be amended to conform with the modern "conception of law as an instrument of social policy".[30] We may look to some American state corporation laws for guidance in this respect. Some American state corporation laws grant the board of directors of a private corporation the *discretion* to determine the amount to be donated for *public purposes.* Thus, the statute of Minnesota provides that any corporation organized under the laws of that state may contribute for the uses of the Government or any of its political subdivisions, or for public welfare "such sums as its board of directors or trustees *may deem proper.*[31]

But, even in the absence of express statutory provision on this point, courts should be reluctant in declaring *ultra vires* the acts of corporations that redound to the benefit of the public. In other words, there should be no *ultra vires* act in so far as corporate acts benefiting the public is concerned. This is so, because, a private corporation, as stated at the beginning, is a mere creation of the state. It is to be presumed that the state would not consent to the creation of any corporation, unless such entity will promote the interests of the public. In other words, all business corporations are created *primarily* because they shall serve a public end, rather than because their creation will only be a source of profits to the owners. The only difference between a natural person — the individual, and an artificial person — the corporation, lies in the manner of their creation. A corporation is created by law. Man is created not by law, but by God. But from the moment both creatures begin to exist, they both become legitimate members of the community in which they live. And, as legitimate members of the community, they must not only live IN the community, but live FOR the community. Many American business corporations realize their true role in community life. There is no reason why Philippine business corporations would do less.

If all private corporations will thus behave and act, Capitalism may eventually pierce the iron curtain and ultimately win the whole world for itself.

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30 See Edmond Cahn, "Some Reflections on the Aims of Legal Educations", II Journal of Legal Education, 1 (1958).

31 See Parker, John S., Corporation Manual of the U.S., 59th Ed., Vol. I, (1959)